Comments Essenscia on draft guidelines State aid measures in the context of the system for greenhouse gas emission allowance trading post 2021

The indirect emission compensation aims to maintain the global competitiveness and survivability of key industries such as the chemical and life sciences industry. The compensation serves to counter existing competition distortion arising from the situation that installations in countries not participating in the ETS do not have to pay the same costs for combating climate change. Accordingly, these installations have a considerable and, as ETS price is rising, increasing comparative cost advantage compared to European installations. Compensation is therefore needed and remains necessary as long as the unilateral EU ETS is not mirrored in climate related initiatives with similar scope and burden in other regions.

In the draft guidelines the commission sets the criteria to determine which sector are eligible for indirect emission cost compensation. The eligibility is more stringent than required by the ETS directive. Moreover, no relief of risk for carbon leakage is proven which would require less protection. Furthermore, concerns exist relating the data used for this assessment, therefore a qualitative assessment should be opened for borderline cases, using a similar criteria as used in the determination of the carbon leakage list (TI x EI > 0,15). This qualitative assessment should be based on a transparent, structured approach similar to the logic applied in phase III. Therefore trade intensity and the fuel and electricity exchangeability are important elements to consider in the qualitative assessment

The draft guidelines stipulates that the CO_2 emission factor shall reflect the production mix of the fossil fuels in the given geographic area. Within this definition only Nordic, Baltic, Iberia, Czechia and Slovakia zones are recognized as a geographic area. As the member states France, Germany, Belgium, Luxembourg and the Netherlands have day-ahead market coupling (known as the Central Western European (CWE) region) this region should also be considered as a geographic area, meaning one CO_2 emission factor should be used within this area, reflecting the emission factor of the marginal power plant in Central Europe.

In this framework we favour the possibility for member states to introduce a “supercap” for certain sectors for which the state aid of 75% would be insufficient. Hence, the amount of the indirect emission costs to be paid at undertaking level can be capped to X % of the gross added.

Energy efficiency measures should not serve as requirement for obtaining the indirect emission compensation, as other regulations like the EU Energy Efficiency Directive already sets requirements on energy efficiency and an efficiency incentive is present by the electricity consumption efficiency benchmarks.

Indirect ETS cost compensation should ensure a level playing field between outsourced and insourced industrial activities in order not to compromise the efficiency of many industrial processes and facilities.

Eligibility

For a correct carbon leakage list, complete and correct data are essential. Incorrect or incomplete data can result in erroneously removal of a sector from the carbon leakage list.

a) Explanatory note does not provide a sufficient base

In the Explanatory Note accompanying the draft ETS Guidelines a qualitative assessment is considered provided the sectors concerned have at least an indirect carbon leakage indicator of 0.2 and that their carbon leakage risk as evaluated by the consultant in the study is at least medium. However, we have several remarks on the consultancy report.

- The report does not communicate in a transparent way about the used data. Moreover, some data are partly unrepresentative that do not appropriately reflect the sector's business realities and market pressures.
- The report states "some sectors with high trade intensity can be net exporters of their products from EU to extra-EU countries and therefore have a limited risk of carbon leakage related to international competitiveness." Sectors with a high trade intensity who are net exporters of their products are definitely also exposed to carbon leakage as they also have to compete with products produced in extra-EU countries (where there is no such indirect carbon cost) but now on the extra-EU market, instead of the EU market as in the case of import. Therefore, trade-intensive sectors will suffer clear competitive impacts on both imports and exports from indirect EU carbon costs and should thus be considered in a qualitative assessment.
- It seems that the argumentation of exchangeability has been dismissed without a clear explanation.
- The report does not take into account future electrification: The chemical industry could shift more from a direct cost base to an indirect cost base in comparison with current energy supplies. The next 10 years (time period of the State Aid Guidelines) are crucial for enabling the scaling of such an industrial transformation. Breakthrough technologies necessary for the chemical industry to contribute to the EU Green Deal all rely on a massive increase of electricity consumption.

Therefore, for borderline situations, there should be a possibility to provide for the necessary data.

b) The uncertainty of the used data should allow a qualitative assessment for borderline cases (= indirect carbon leakage indicator > 0,15)

The GVA and electricity consumption data have an high impact on the indirect carbon leakage indicator.

The GVA is reported on a company basis. Dependent on the company structure (and portfolio), reported GVA contributions for one NACE 4 code can contain data from many different products and processes (including from other NACE 4 code sectors) as well as non-NACE 4 code specific GVA contributions (like non-production personal and R&D costs or income from participations and investments). This could lead to an overestimation of the GVA which has an high impact on the indirect carbon leakage indicator.

The used electricity consumption data is incomplete as only 17 Member States out of 29 (EU-28 + Norway) have submitted electricity consumption data. The coverage of the data collection resulted in ca. 70% of total indirect emissions covered. This could lead to an underestimation of the electricity consumption data.

c) Exchangeability between fuel and electricity should be an import factor in the qualitative assessment

In the Consultant report the Fuel and electricity exchangeability was considered as a criteria but it was concluded that "the level of risk on the fuel and electricity substitutability criteria is deemed low due to low variability between undertakings in the sector based on their gas and electricity consumption in their production processes." It is unclear how they came to this conclusion nor why the low variability is an important factor to consider when determining the risk of carbon leakage.

Electrification is one way for industry to reduce their emissions and the ETS State Aid Guidelines should allow manufacturing sectors to implement electrification investments in ETS Phase IV. For several processes the technology to use fuel or electricity to produce heat or mechanical energy for the production of an equivalent product already exist. For such processes the emissions from electricity (indirect emissions) and fuel (direct emissions) are considered in the determination of the relevant product benchmark however allocation is based on the direct emissions only. If the sector is on the carbon leakage list, meaning a high risk for carbon leakage exists, this risk is still present when the company switches from fuel to electricity. Therefore the indirect emissions costs should also be compensated to avoid carbon leakage. This was recognized in the qualitative assessment in phase III where the exchangeability between fuel and electricity was considered an important element and it should again be an import element in the qualitative assessment of phase 4.

d) Proposal Qualitive assessment

We suggest that the assessment for eligibility for indirect compensation should be in accordance with the approach used in Phase III EU ETS, with new criteria used in phase IV.

The quantitative assessment identified sectors as eligible for Indirect Electricity Compensation (Annex I) where all three of the following criteria are fulfilled:

- TI x emission Intensity (EI), measured in kg CO2/ GVA (euro)> 0,2
- EI > 1
- TI > 20 (%)

Accordingly, a qualitative assessment should be open for sectors or subsectors:

- Borderline sectors i.e. NACE-4 sectors with TI x EI > 0,15 (in line with direct emission allocation).
- To sectors and subsectors (including at Prodcom level (2)) for which official data are missing or are of poor quality.
- To sectors and subsectors (including at Prodcom level) that can be considered to have been insufficiently represented by the quantitative assessment.

CO_2 emission factor and geographical areas

The draft State Aid Guidelines propose a fragmentation of the current Guidelines' power market regions. The justification is an assessment in a report accompanying the draft Guidelines that price convergence in the Central and Western Europe (CWE) has decreased. This is hard to follow. Cross-border interconnector capacity has consistently increased in the last ten years, and the improved physical connection is amplified by an increased use of flow-based market coupling. An empirical examination of day-ahead power prices shows more price convergence and correlation, not less, in most countries.

This is also confirmed in the Report from the Commission and the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions -

Energy prices and costs in Europe[1] -: *"In the wholesale electricity market, increasing market coupling and interconnectors are clearly creating price convergence (an indication of more efficient markets), except during extreme price spikes and troughs when local supply differences are too great to be bridged across Member States."* and *"First, the creation of the single market helps to protect the EU from volatile prices affecting an individual Member State. With interconnections, (…), coupled markets and dynamic pricing, flexibility and growing trade between Member States provide a buffer against international price spikes. The broadly growing convergence in prices across Member States suggests that these efforts are bearing fruit."*

In addition further market improvement measures as planned and pushed by electricity legislation (like the new market design) and further investments in transmission capacity will alleviate structural price differences and further improve market coupling (covariance).

In any case, price observations clearly show that price differences between Member States (especially in coupled markets) are substantially lower than the difference in energy mix in each individual Member State. This proves that market coupling (even if substantially less than 1% of the spot prices are completely equal) effectively leads to price convergence through the merging of the national merit order books. The compensation can therefore not be calculated on the basis of national merit orders alone.

[1] *SWD(2019) 1 final*